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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE CANADA MARCH 2006

OVERVIEW

- In the fourth quarter of 2005 real gross domestic product (GDP) grew 2.5%, following a 3.5% gain in the third quarter. For 2005 as a whole, GDP increased 2.9%, the same rate as in 2004.
- Final domestic demand climbed 4.3% in the fourth quarter, reflecting healthy employment, income and profit growth. Non-residential investment in plant and equipment led the way.
- Net trade retarded growth. Real imports climbed 11.4%, satisfying increased domestic demand, notably the need for machinery and equipment. Real exports rose a solid but more modest 9.6%.
- With its 26th consecutive quarterly surplus, the current account balance jumped $22.1 billion to a record level of $53.1 billion, or 3.8% of nominal GDP. For 2005 as a whole, the current account surplus stood at a record level of $30.2 billion, or 2.2% of nominal GDP, the same share as in 2004.
- Since the end of 2004 the Canadian economy has created 305,700 net new jobs, close to 90 per cent of which are full-time. The 6.4% unemployment rate in February matched the lowest level in over 30 years.

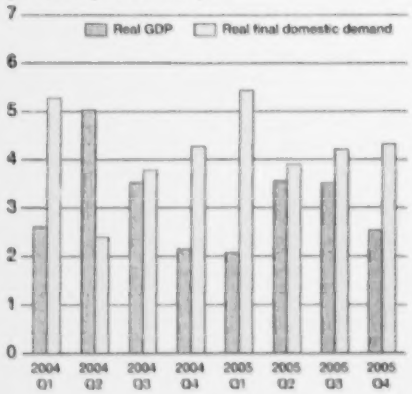
Real GDP grows 2.5%

Real GDP rose 2.5% in the fourth quarter. Final domestic demand growth remained solid (Chart 1), but imports increased more than exports, moderating output growth.

Consumer spending growth picks up

Real consumer spending grew 2.9% in the fourth quarter, a modestly stronger pace than in the third quarter. Spending on non-durables, semi-durables and services grew faster than in the third quarter while purchases of durables actually declined as sales of motor vehicles and automotive parts dropped sharply.

Chart 1
Growth in real GDP and real final domestic demand
per cent (annual rate)



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is end of day, March 10, 2006.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	2004	2005	2005:Q2	2005:Q3	2005:Q4		Most recent
Real gross domestic product	2.9	2.9	3.6	3.5	2.5		–
Final domestic demand	3.9	4.3	3.9	4.2	4.3		–
Government expenditure							–
Goods and services	2.7	2.8	3.2	4.4	3.6		–
Gross fixed capital	4.9	4.2	1.8	5.0	11.1		–
Consumer expenditure	3.4	4.0	3.8	2.4	2.9		–
Residential investment	8.3	3.3	6.7	2.5	1.4		–
Business fixed investment	6.1	9.1	4.4	13.8	12.9		–
Non-residential construction	0.8	6.8	6.5	11.7	12.3		–
Machinery and equipment	9.8	10.7	2.9	15.3	13.3		–
Business inventory investment ($ billion)	11.5	14.3	12.9	14.4	11.9		–
Exports	5.0	2.3	-0.5	7.4	9.6		–
Imports	8.1	7.0	-3.2	10.2	11.4		–
Current account balance							
(nominal $ billion)	28.8	30.2	20.2	31.0	53.1		–
(percentage of GDP)	2.2	2.2	1.5	2.2	3.8		–
Nominal personal income	4.3	4.9	6.2	6.3	5.8		–
Nominal personal disposable income	3.9	4.0	4.9	7.0	5.3		–
Real personal disposable income	2.5	2.4	2.8	4.5	5.0		–
Profits before taxes	18.7	10.7	12.3	20.0	16.4		–
Costs and prices (%, y/y)							
GDP price deflator	3.0	3.1	2.3	3.1	4.1		–
Consumer Price Index	1.9	2.2	1.9	2.6	2.3	2.8	Jan-2006
CPI excluding eight most volatile items	1.5	1.6	1.6	1.6	1.6	1.7	Jan-2006
Unit labour costs	1.1	2.3	1.9	2.7	3.4		
Wage settlements (total)	1.7	2.3	2.6	2.8	1.7	1.7	Dec-2005
Labour market							
Unemployment rate (%)	7.2	6.8	6.8	6.8	6.5	6.4	Feb-2006
Employment growth	1.8	1.4	1.7	1.5	2.4	1.5	Feb-2006
Financial markets (average)							
Exchange rate (cents U.S.)	77.0	82.6	80.4	83.3	85.2	86.10	10-Mar-06
Prime interest rate (%)	4.0	4.4	4.3	4.3	4.8	5.50	09-Mar-06

Note: Real values are in chained 1997 dollars.
Sources: Statistics Canada, the Bank of Canada and Human Resources and Social Development.

The 5.8% increase in personal income in the fourth quarter followed a 6.3% gain in the third. While employment rose more than in the third quarter, average hours worked per employee inched lower. Real personal disposable income climbed for the ninth consecutive quarter, up 5.0%. Per capita real personal disposable income increased 3.6%. The personal savings rate was 0.3% in the fourth quarter, the only quarter in 2005 in which consumers spent less than their disposable income.

Residential investment increases

Residential investment increased 1.4% in the fourth quarter after gaining 2.5% in the third. Rising interest rates likely slowed the housing market, but low rates still supported a high level of activity. While renovations jumped 11.2%, a dip in housing starts fostered a modest decrease in new construction activity, the fourth consecutive quarterly decline. Housing resale activity dropped.

Business fixed investment climbs

Supported by record profits, high capacity utilization, and lower import prices due to the appreciating dollar, business spending on plant and equipment registered a 12th consecutive increase in the fourth quarter, growing 12.9%. Investment in machinery and equipment jumped 13.3%. Except for motor vehicles, all types of investment showed significant gains, with spending on other transportation equipment soaring in the quarter.

Non-residential construction increased a robust 12.3% after a slightly smaller third-quarter gain. For the fourth consecutive quarter, both building construction, such as office towers and shopping malls, and engineering projects contributed to growth. Higher energy prices have boosted investment in the oil and gas extraction industry, increasing engineering projects.

Business inventory accumulation slows

Businesses increased inventories by $11.9 billion, down from $14.4 billion in the third quarter. The slowdown was concentrated in durable goods and wholesale trade industries. The inventory-to-sales ratio edged lower.

Exports rise

Real exports increased 9.6% in the fourth quarter (Chart 2). As in the third quarter, exports of cars jumped as strong U.S. sales in the second and third quarters reduced U.S. inventories. Exports of machinery and equipment and forest products both rebounded from previous declines. Machinery and equipment exports have benefited from strong U.S. machinery and equipment investment since 2003. Exports of forest products rose with U.S. residential investment plus demand from rebuilding projects in the U.S. following Hurricane Katrina. Exports of services increased 2.9%.

Imports increase more than exports

Real imports rose 11.4%, the second consecutive double-digit increase. Most major categories saw solid gains. Boosted by robust investment growth, imported machinery and equipment climbed 19.2%, an 11th consecutive increase. Non-automotive consumer products also registered a second consecutive double-digit increase. Imported services increased 3.9%.

Current account surplus mounts to record

In the fourth quarter, the terms of trade rose. Export prices jumped with the price of exported energy products while import prices fell, in part because of an appreciating dollar. Thus, despite the negative contribution of real trade, the nominal trade surplus soared $16.0 billion. Further, increased dividends from abroad received by Canadians and decreased income paid to non-residents from Canadian profits improved the investment income deficit by

Chart 2
Growth in real exports and real imports

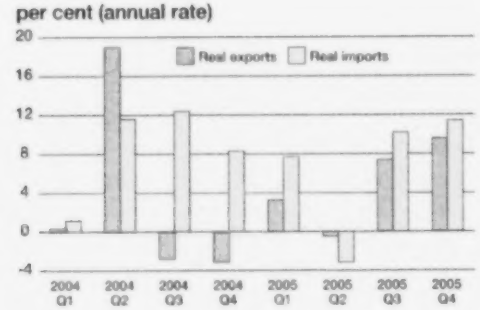
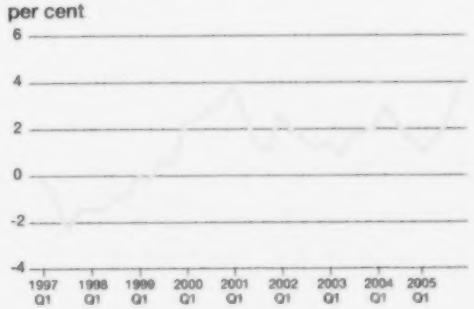


Chart 3
Current account as a percentage of nominal GDP



$6.6 billion. The current account surplus climbed $22.1 billion to a record level of $53.1 billion and at 3.8% sat a fraction below its record share of nominal GDP (Chart 3). For 2005 as a whole, the current account surplus stood at a record level of $30.2 billion, or 2.2% of nominal GDP.

Corporate profits grow again

Corporate profits rose 16.4% in the fourth quarter following a 20.0% third-quarter gain. A strong upward trend in profits has raised their share of GDP to a record 14.6%, well above the 10.2% historical average since 1961 (Chart 4). Financial enterprises reported significant gains and mining companies other than those involved in oil and gas extraction benefited from rising metal prices.

Consumer price inflation remains subdued

Reflecting higher world commodity prices, the GDP deflator, a comprehensive measure of prices, rose over 5% in the fourth quarter to stand 4.1% higher than a year earlier.

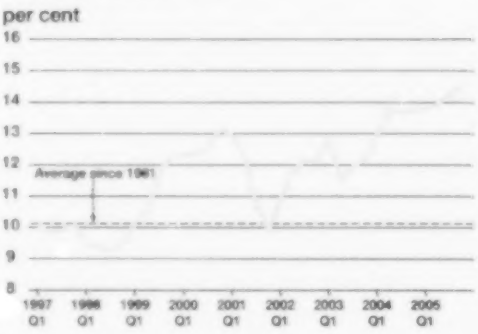
Year-over-year consumer price inflation stood at 2.8% in January, up from 2.2% in December, as prices for gasoline, natural gas and fresh vegetables rose. At 1.7% in January, core CPI inflation, which excludes the eight most volatile items, sat below the mid-point of the 1% to 3% target band.

Unemployment rate remains near low

Employment grew 2.4% in the fourth quarter, and another 51,000 jobs were added in January and February. Since the end of 2004 the Canadian economy has created 305,700 net new jobs, the majority of them full-time. The participation rate stood at 67.0% in February, down slightly from January and from its record high of 67.7% set in the second quarter of 2004.

The unemployment rate declined 0.2 percentage points in February and sat at 6.4%, matching the lowest level in over 30 years last reached in November 2005.

Chart 4
Profits before taxes as a share of nominal GDP



Hourly labour productivity increased 0.7% in the fourth quarter and was 1.3% higher than a year earlier. Labour costs per unit of output rose 4.8% in the fourth quarter to stand 3.4% higher than a year earlier.

Bank of Canada raises policy rate

On March 7, the Bank of Canada raised its key policy rate—the target for the overnight rate—by one quarter of a percentage point to 3.75 per cent, the fifth increase in a six-month period. The Bank stated that "some modest further increase in the policy interest rate may be required to keep aggregate supply and demand in balance and inflation on target over the medium term." The U.S. Federal Reserve raised its target rate 14 times from 1.25% in June 2004 to 4.50% in January 2006. U.S. interest rates are higher than rates in Canada at all maturities.

The Canadian dollar climbed to close at a 14-year high of 88.39 cents U.S. on March 2. It then eased to 86.10 cents U.S. on March 10.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre at (613) 995-2855. For other inquiries about this publication, contact Steven James at (613) 992-4321. Also available on the Internet at www.fin.gc.ca
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